

STATE OF NEW JERSEY

Board of Public Utilities

*Two Gateway Center
Newark, NJ 07102*

ENERGY

IN THE MATTER OF THE PETITION OF)
ATLANTIC CITY ELECTRIC COMPANY FOR)
APPROVAL OF THE SALE OF ITS NUCLEAR)
GENERATING UNITS)

DECISION AND ORDER

DOCKET NO. EM99110870

(SERVICE LIST ATTACHED)

BY THE BOARD:

This Order memorializes and provides the reasoning for the actions taken by the Board of Public Utilities ("Board") in this matter, by a vote of three Commissioners, at its May 15, 2000 special public agenda meeting.

On November 23, 1999, Atlantic City Electric Company ("ACE" or "Company") filed a petition seeking the Board's approval of the sale of the Company's minority interests in the Salem Nuclear Generating Station Units 1 and 2 ("Salem"), Peach Bottom Power Station Units 2 and 3 ("Peach Bottom"), and the Hope Creek Nuclear Generating Station ("Hope Creek") (collectively, "Nuclear Assets").¹ The Company is also seeking certain specific findings by the Board relating to the eligible stranded costs associated with the sale.

By Order in this Docket, dated July 21, 2000 ("July 2000 Order"), the Board approved the sale of the Company's interests in Salem and Hope Creek to PSEG Power LLC ("PSEG Power"), an unregulated subsidiary of Public Service Enterprise Group, the parent company of Public Service Electric & Gas Company ("PSE&G"), and the sale of one-half of the Company's interest in Peach Bottom to each of PSEG Power and PECO Energy Company ("PECO"). In the July 2000 Order, which sets forth the procedural history of this proceeding in detail, the Board stated that it would address in a separate Order, i.e., this Order, the issue of eligible stranded costs associated with the Nuclear Assets, as well as the Company's proposed allocation of a portion of losses on reacquired debt to the Nuclear Assets for inclusion in eligible stranded costs. This Order also addresses the treatment to be accorded the Company's nuclear-related regulatory assets and Merrill Creek costs in accordance with the Board's decision rendered at its public agenda meeting held on May 15, 2000.

As noted above, and pursuant to the Electric Discount and Energy Competition Act, N.J.S.A. 48:3-49 et seq. ("EDECA" or "Act"), ACE requests certain Board findings relating to the eligible stranded costs associated with sale of the Company's Nuclear Assets. Specifically, ACE seeks a determination by the Board as to the quantification of the Company's eligible stranded costs

¹ The Company owns 7.41% of Salem (162 MW), 7.51% of Peach Bottom (164 MW), and 5% of Hope Creek (52 MW).

associated with sale of the Nuclear Assets as defined by N.J.S.A. 48:3-51.² Pursuant to N.J.S.A. 48:3-61(a)(1), ACE also seeks a finding by the Board that the Company may recover such eligible stranded costs. Lastly, ACE seeks a finding by the Board, pursuant to N.J.S.A. 48:3-62(c)(1), that the full amount of eligible stranded costs either may constitute, or be included as part of, the principal amount of transition bonds for which the Company may seek approval to issue under the Act. With regard to the request concerning transition bonds, the Board, in its July 2000 Order, stated that it would reserve its decision regarding the amount, if any, of stranded costs eligible for securitization until a later date after the Company's sale of its fossil assets has been evaluated and considered by the Board.

Stranded Costs Estimate

In quantifying its estimated stranded costs, from the \$11.3 million sales price received for the Nuclear Assets,³ the Company deducted estimated transaction costs associated with the sale, the book value of the Nuclear Assets, construction work in progress, fuel and other inventories, construction and other advances, nuclear-related regulatory assets, and finally, allocated portions of Merrill Creek costs and losses on reacquired debt. The Company's initial estimated quantification of \$532.6 million was based on the book value of the Nuclear Assets as of July 31, 1999. (Petition, Exhibit D). After updating to reflect the book value of the assets as of December 31, 1999, the estimate was reduced to \$513.8 million (Exhibit D - Update No. 1, submitted in response to Staff discovery request S-NS-19). In each case, the estimates do not reflect the tax reductions associated with the remaining tax basis of the units and other deductible costs. On a "net-of-tax" basis, the Company's updated stranded costs estimate based on the December 31, 1999 book value of the Nuclear Assets is \$303.9 million (Exhibit D - Update No. 1).

Included among the items sought by the Company for recovery as stranded costs are a loss on reacquired debt, certain regulatory assets and the Company's interest in the Merrill Creek Reservoir Project. The following is a discussion of these items.

Loss on Reacquired Debt

ACE is seeking recovery of a loss on reacquired debt associated with the Nuclear Assets, in an amount of approximately \$3.6 million net-of-tax as of December 31, 1999 (Exhibit D – Update No. 1). A loss on reacquired debt is incurred when higher cost debt is refunded with lower cost debt to take advantage of declining interest rates, which typically requires the upfront payment of a premium, or an amount above face value, on the redeemed bonds.

ACE asserts that, over the years, Company debt has been retired in refunding transactions, and that the allocation of a portion of these deferred costs to the Nuclear Assets is appropriate. ACE asserts that the allocation was based on the net book plant value of the Nuclear Assets.

² "Stranded cost" is defined in N.J.S.A. 48:3-51 as "the amount by which the net cost of an electric public utility's electric generating assets..., as determined by the [B]oard consistent with the provisions of this [A]ct, exceeds the market value of those assets...in a competitive supply marketplace...".

³ In addition to the sales price, ACE is to be compensated by the purchasers for its share of the net book value of the nuclear fuel at each unit as of the closing date.

Regulatory Assets⁴

The Company's stranded cost calculation includes two regulatory assets, "Design Basis Documentation" and "Hydrogen Water Study Costs," with an aggregate value of approximately \$2.4 million net-of-tax as of December 31, 1999 (Exhibit D – Update No. 1).

Merrill Creek Reservoir Project ("Merrill Creek") Entitlement

The Delaware River Basin Commission requires ACE, as an operator of generation facilities that draw cooling water from the Delaware River, to maintain the ability to return an equivalent water volume to the river during periods of low flow. For that purpose, ACE acquired a partial ownership interest in Merrill Creek, which provides water storage capacity for water replenishment to the Delaware River. The Company asserts that its interest in Merrill Creek will become a stranded cost upon the closing of the sale, as the purchasers already have adequate water storage capacity entitlements in Merrill Creek to meet the complete needs of the Nuclear Assets.

Therefore, ACE is seeking inclusion of certain Merrill Creek expenses associated with the sale of the Nuclear Assets. The expenses consist of the pro-rated book value of Merrill Creek and the present value of future related and operations and maintenance expenses in an amount of approximately \$4.7 million.

Division of the Ratepayer Advocate's ("Advocate") Initial Comments

By letter dated March 3, 2000, the Advocate filed comments on ACE's petition. The Advocate raised a number of concerns, which were addressed in the July 2000 Order, including an argument that ACE did not receive full market value for the Nuclear Assets and that the administrative estimate derived at the OAL proceedings be used as the basis to determine the stranded costs of the Nuclear Assets.

The Advocate additionally urged the Board to defer issuing a final ruling on both the level of ACE's Nuclear Assets stranded costs and whether such costs may be securitized until the Board acts on the Company's petition for approval of the sale of its non-nuclear units in Docket No. EM00020106, and issues a Final Order in the Company's rate unbundling, stranded costs and restructuring proceedings, Docket Nos. EO97070455, EO97070456 and EO97070457 (collectively, the "restructuring proceedings")⁵ (Advocate's Initial Comments at 8). This issue was also addressed in the July 2000 Order.

In considering the Company's proposed treatment of losses on reacquired debt, the Advocate urged the Board to first ascertain the level of such costs included in current rates in order to prevent the possibility of a double recovery. (Advocate's Initial Comments at 37-39). With

⁴ "Regulatory asset" is defined in N.J.S.A. 48:3-51 as "an asset recorded on the books of an electric public utility...pursuant to the Statement of Financial Accounting Standards, No. 71, entitled ["]Accounting for the Effects of Certain Types of Regulation," or any successor standard and as deemed recoverable by the [B]oard;"

⁵ Subsequent to the Advocate's comments, a Final Order in the Company's restructuring proceedings was issued on March 30, 2001.

respect to the tax adjustments included by the Company in its calculation of stranded costs, in the event the Board approves the sale, the Advocate urged the Board to direct the Company to include in the post-closing calculation of stranded costs a detailed analysis and explanation of how all of the tax effects, including SFAS ("Statement of Financial Accounting Standard") 109, deferred ITC (Investment Tax Credits) and deferred income tax reserves are included in the calculation, in compliance with paragraph 17 of the June 9, 1999 Stipulation of Settlement adopted, with modifications, by the Board by Summary Order issued on July 15, 1999 in the restructuring proceedings ("Summary Order"). (Id. at 34).

Company's Initial Comments

In its initial comments filed by letter dated March 3, 2000, the Company reiterated the pleadings set forth in its petition, and additionally noted that in the Summary Order, the Board found that "the Company shall be permitted the opportunity to recover 100% of its net owned generation stranded costs (established definitively upon completion of the divestiture)." (Company's Initial Comments, at 7, quoting the Summary Order at 4).

Advocate's Reply Comments

By letter dated March 17, 2000, the Advocate reasserted many of the arguments and positions set forth in its initial comments. The Advocate also reiterated the need to ensure that the Company's proposed treatment of losses on reacquired debt did not result in an overrecovery, and in the event the Board approved the sale, urged the Board to limit ACE's stranded cost recovery to \$243.9 million, net-of-tax (the administrative estimate developed in the Company's stranded costs proceeding at the Office of Administrative Law), subject to a further adjustment to reflect additional stranded cost recovery from rates through the date the sale closes.

Company's Reply Comments

In its reply comments dated March 7, 2000, ACE responded to the arguments raised by the Advocate. ACE asserted that the Advocate's argument concerning the possibility of the Company double recovering certain debt-related costs, namely the loss on reacquired debt, is incorrect. ACE asserted that, under EDECA, the Company was required to unbundle its rates, identifying and assigning costs related to the provision of transmission and distribution, and generation, services. The Company argued that inclusion of loss on reacquired debt in the stranded cost calculations is to ensure that the generation-related portion of this cost is included as a stranded cost and recovered as such. The Company argued that the Advocate does not dispute the Company's entitlement to recover this cost, and that the Advocate has been provided specific detailed information on this issue and that the Advocate should be assured that there will be no double recovery (Company Reply Comments at 25).

Discussion and Findings

Having reviewed the record in this matter as it relates to the quantification and recoverability of eligible stranded costs associated with the approved sale of ACE's Nuclear Assets, the Board

FINDS that the starting point for consideration should be the Company's summary of eligible stranded costs, as estimated in Exhibit D - Update No. 1, on a net-of-tax basis, of \$303.9 million as of December 31, 1999. This estimate will be subject to the adjustments described below. This estimate will be further adjusted at closing to reflect actual data at the time of closing, and the actual amount shall be provided to the Board and the Advocate subsequent thereto.

With regard to ACE's proposed stranded cost recovery of loss on reacquired debt in an approximate amount of \$3.6 million, the Board believes that it is inappropriate for the Company to recover this item as a stranded cost. The Board FINDS that such costs do not fall within EDECA's definitions of stranded costs or bondable stranded costs, as set forth in N.J.S.A. 48:3-51. Thus, this amount should be subtracted from the aforementioned \$303.9 million estimate. Therefore, the Board FINDS that losses on reacquired debt do not meet the criteria for stranded cost recovery under EDECA. To the extent these costs have not been reflected in current rates, ACE may seek recovery of such unamortized costs in its next base rate proceeding, at which time all of the Company's costs and revenue will be evaluated by the Board. At that time, the issue of any double recovery can be more fully explored. The Company can continue to defer such unamortized losses until the Board makes a decision in the Company's next base rate case.

ACE's unbundled rates provide for the recovery of regulatory assets as a separately identified component, subject to adjustment upon the expiration of an individual asset's recovery. The Board believes that the proposed inclusion of \$2.4 million for the two aforementioned regulatory assets as stranded costs is inappropriate. The Board FINDS that these regulatory assets shall not be eligible for recovery as stranded costs, but the Company shall be permitted to seek recovery of these regulatory assets through an alternate mechanism to be determined in its next base rate case proceeding. Thus, this amount shall also be subtracted from the \$303.9 million estimate. The Company can continue to defer these regulatory assets until the Board makes a decision in the Company's next base rate case.

The Board recognizes that the Nuclear Assets-related portion of the Company's interest in Merrill Creek will no longer be used and useful upon the closing of the sale of the Nuclear Assets, as discussed above. The Board FINDS it appropriate to allow certain Merrill Creek expenses, in an approximate amount of \$4.7 million, to remain as eligible stranded costs at this time. However, the Board also recognizes that Merrill Creek has potential prospective value for generation facilities that may be constructed in the Delaware River Basin during the term for which ACE has an entitlement to water storage capacity in Merrill Creek. Also, ACE has the duty to mitigate its stranded costs. Therefore, the Company is DIRECTED to use its best efforts to sell or lease all or part of its interest in Merrill Creek so as to mitigate its stranded costs. The Board further DIRECTS that all revenues resulting from any sale or lease shall be returned to customers as a credit against stranded costs charges.

As a result of the above adjustments to ACE's proposed level of eligible stranded cost recovery associated with the sale of the Nuclear Assets, the Board HEREBY DETERMINES the amount of stranded costs, eligible for recovery by the Company, as defined by N.J.S.A. 48:3-51, to be approximately \$297.9 million as of December 31, 1999, subject to further adjustment at the time of closing and subsequent verification to reflect actual data at the time of closing. Pursuant to N.J.S.A. 48:3-61(a)(1), the Board HEREBY FINDS that the Company shall have the opportunity to recover such eligible stranded costs through the Company's Market Transition Charge, in a time frame and manner to be determined by the Board.

DATED: September 17, 2001

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)

FREDERICK F. BUTLER
COMMISSIONER

ATTEST: (SIGNED)

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